268

DEC 15 1924
WM. R. STANSBURY
CLERK

DOCKET No. 443.

Supreme Court of the United States,

OCTOBER TERM, 1924.

RAY CONSOLIDATED COPPER COMPANY, A CORPORATION,
Appellant,

against

UNITED STATES OF AMERICA.

BRIEF FOR APPELLANT.

ARTHUR A. BALLANTINE,
CARROLL A. WILSON,
GEORGE E. CLEARY,
Attorneys for Appellant.

The Evening Post Job Printing Office, Inc., 154 Fulton St., New York, N. Y.

INDEX.

	PAGE
STATEMENT OF CASE	3
ASSIGNMENT OF ERRORS	8
THE STATUTE	9
THE ISSUES	11
ARGUMENT	13
I. The statutory measure of the tax is the fair average value of the shares of capital stock, not the value of the corporate property	16
A. The text of Section 1000 shows that the phrase "fair average value of its capital stock for the preceding year" is used in the sense of the value of shares of capital stock, not in the sense of the value of property and business	16
(1) Share values can form the basis of an "average for the preceding year", as contemplated by the statute; assets or property values do not form a practicable basis for such an averege	16
(2) That "capital stock", as used in subdivision (1) of Section 1000 (a) is used in the sense of shares of stock, is established by the contrasting use of the word "capital" in subdivision (2)	20
Discussion of *Hecht* v. *Malley*	20
(3) The special statutory provisions as to mutual insurance companies support appellant's position	26
(4) The statutory reference to "surplus and undivided profits" is consistent with appellant's view	28
(5) The statutory use of the word "estimating" does not indicate that what is to be estimated is the value of the assets rather than the value of the shares	36

PAGE

B. The legislative history of this statute and of statutes in *pari materia* preceding it shows that Congress intended that the measure of the tax on domestic corporations should be the fair average value of the shares of stock, and not the value of corporate assets 38

C. The statute should not be construed in such a way as to impose upon taxpayers and the Government the burden of frequent revaluations of all corporate property and business in the United States, including the value of intangible assets 50

D. The fact that this statute is a federal excise tax on corporations does not indicate that the measure of the tax is the value of the corporate net assets or that a broad, flexible and indefinite measure must be adopted. The use of the fair average value of the shares as the measure of the tax is consonant with the general purpose and nature of the statute 55

Discussion of *Central Union Trust Company v. Edwards* 59

E. Measured by the value of shares of stock, the capital stock tax is constitutional; measured by the value of assets it is in substance an unapportioned direct tax and of doubtful constitutionality 63

II. The fair average value of the shares of stock is primarily determined from market transactions when available in sufficient volume 68

III. The Treasury has in practice construed the law as if it measured the tax by (1) assets, (2) shares, or (3) capitalized earnings, whichever is higher. This construction of the statute is erroneous, even if presented under the guise of a broad meaning for the term "capital stock" 75

Appendix 85

CITATIONS.

PAGE

Cases:

Bailey *v.* Drexel Furniture Co., 259 U. S. 20.......... 64
Baldwin Locomotive Works *v.* McCoach, 221 Fed. 59.. 32

Central Granaries Co. *v.* Lancaster County, 77 Neb. 311 17
Central Union Trust Co. *v.* Edwards, 287 Fed. 324.... 12, 13, 59, 78, 80, 81, 82
Child Labor Tax Case, 259 U. S. 20.................. 64, 65
Church of the Holy Trinity *v.* United States, 143 U. S. 457.. 38
Commonwealth *v.* Carey Improvement Co., 98 Mass. 19 .... 14, 70
Commonwealth *v.* Hamilton Mfg. Co., 12 Allen 298 ....14, 58, 62
Cornell *v.* Coyne, 192 U. S. 418...................... 56

Delaware & Hudson R. R. Co. *v.* I. C. C., pending U. S. Supreme Ct............................ 52
Delaware Railroad Tax, The, 18 Wall, 206.........55, 62, 67
Des Moines Natl. Bank *v.* Fairweather, *et al.*, 263 U. S. 103 14
Douglas *v.* Edwards, 298 Fed. 229.................. 31
Duncan *v.* Landis, 106 Fed. 839...................... 69

Flint *v.* Stone Tracy Co., 220 U. S. 107......55, 57, 64, 65
Fox *v.* Phelps, 17 Wend. (N. Y.) 393............... 68

Hamilton Co. *v.* Massachusetts, 6 Wall. 632........55, 62, 67
Hecht *v.* Malley, 265 U. S. 144..................1, 20, 21, 28
Henderson Bridge Co. *v.* Commonwealth, 99 Ky. 623.. 30
Hersh *v.* The Northern Central Rwy. Co., 74 Pa. 181.. 17
Hetland *v.* Bilstad, 140 Iowa, 411.................... 68
Home Savings Bank *v.* Des Moines, 205 U. S. 503..... 29
Hood Rubber Co. *v.* Commonwealth, 238 Mass. 369.... 13

Jones *v.* Marrs, 263 S. W. 570 (Texas).............. 17

Kingston *v.* Home Life Insurance Co. of America, 101 Atl. 898 (Del.)................................ 32

LaBelle Iron Works *v.* United States, 256 U. S. 377 33, 50, 54
Leather Manufacturers National Bank *v.* Treat, 128 Fed. 262.. 39
Long *v.* Ottumwa Railway & Light Co., 162 Ia. 11.... 16

McCray *v.* United States, 197 U. S. 27................ 56

PAGE

National Bank of Commerce *v.* New Bedford, 155 Mass. 313 .... 14, 70
National Bank of Commerce *v.* New Bedford, 175 Mass. 257 .... 14, 62, 70
Newark *v.* Tunis, 82 N. J. Law, 461 70

Pacific Hotel Co. *v.* Lieb, 83 Ill. 602 30
Palmer *v.* Penobscot Lumbering Association, 90 Maine, 193 68
Patton *v.* Brady, 184 U. S. 608 56
People *v.* Cantor, 236 N. Y. 417 58
People *ex rel.* Knickerbocker Fire Ins. Co. *v.* Coleman, 107 N. Y. 541 69
People *ex rel.* Union Trust Co. *v.* Coleman, 126 N. Y. 433 .... 14, 30, 57, 81
Pollock *v.* Farmers Loan & Trust Co., 157 U. S. 429 .... 64, 65
Powers *v.* Detroit & Grand Haven Railway, 201 U. S. 543 .... 13, 37
Pullman's Palace Car Co. *v.* Central Transportation Co., 171 U. S. 138 14

Railroad Companies *v.* Gaines, 97 U. S. 697 25

Schley *v.* Montgomery County, 106 Md. 407 .... 14, 69, 70
Sexton *v.* C. L. Percival Co., 177 N. W. 83 (Iowa) 31
Southern California Home Builders *v.* Young, 188 Pac. 586 (Cal. App.) 32
Spreckels Sugar Refining Co. *v.* McClain, 192 U. S. 397 57
Swift & Co. *v.* Board of Assessors, 115 La. 321 (1905) 17

Tennessee *v.* Whitworth, 117 U. S. 129 .... 13, 24
T. P. Cochrane *v.* Interstate Packing Co., 139 Minn. 452 31

United States *v.* Delaware & Hudson Co., 213 U. S. 366 63
United States *v.* Singer, 15 Wall 111 56
United States *v.* St. Paul M. & M. Ry. Co., 247 U. S. 310 38

Van Allen *v.* The Assessors, 3 Wall. 573 14

Statutes:

Act of June 13, 1898 (30 Stats. 448) 39
Bankers Tax Law, Oct. 22, 1914 (38 Stats. 750) 28, 36, 38
Constitution of U. S., Art. I, Sec. 2, Par. 3 63
Sec. 182, Judicial Code (36 Stats. 1142) 3
Section 407, Revenue Act of 1916 (39 Stats. 789) 39, 46
Section 301, Revenue Act of 1918 (40 Stats. 1088) 49
Sections 311-12, Revenue Act of 1918 (40 Stats. 1090) 49
Section 700, Revenue Act of 1924 (June 2, 1924) 75, 89
Section 1000, Title X, Revenue Act 1918 (40 Stats. 1126) 1, 2, 8, 9, 13, 16, 19, 20, 26, 28, 35, 46, 75

PAGE

Miscellaneous:

Advisory Tax Board Memo. 73, C. B. 1919, p. 71..... 69
Advisory Tax Board Rec. 57, C. B. 1919, p. 40...... 69
Committee on Appeals & Review, Rec. 33, C. B., June, 1920, p. 30.................................... 69
Committee on Appeals & Reviews, Rec. 2771, C. B., II-2, p. 18.................................... 70
Committee on Appeals & Review, Rec. 4837, C. B., III-1, p. 39.................................... 70
Congressional Record, 64th Cong. 1st Session, Vol. 53, Pt. 13, p. 14118.............................. 45
Cook on Corporations, V. 1, § 8, p. 46, 8th Ed....... 13
Cook on Corporations, V. 1, § 8, p. 47, 8th Ed....... 57
Corpus Juris, V. 6, p. 873.......................... 17
Corpus Juris, V. 9, p. 1280......................... 13
Fletcher Cyc. Corporation, V. 5, p. 5584.............. 13
Form 707—1925 Return—Capital Stock Tax........ 51, 76
Form 708—1925 Return—Capital Stock Tax........ 20
H. R. 12863, 65th Congress, 3d Session, Committee Print as agreed to in Conference................ 47
House Report No. 1037—65th Congress, 3d Session, p. 84.. 47
Regulations 38, Art. 6.......................29, 35, 75, 85
Regulations 63, Arts. 13, 14......................... 69
Regulations 64, Article 15 ....18, 75, 87
Regulations 64, Article 16.......................... 33
Regulations 64, Article 24.......................... 20
Regulations 64, Article 26.......................... 26
Regulations 64, Article 27.......................... 20
Senate Report No. 617, 65th Cong. 3d Session, p. 11... 49
Tax Simplification Board, First Report 52, 89

Supreme Court of the United States,

OCTOBER TERM, 1924.

RAY CONSOLIDATED COPPER COMPANY, a Corporation, Appellant, against THE UNITED STATES OF AMERICA.	No. 448.

BRIEF FOR APPELLANT.

This appeal presents for review the final decision of the United States Court of Claims dismissing on the merits appellant's petition for the refund of capital stock taxes.

The question at issue is the measure to be used for determining the capital stock tax on domestic corporations imposed by Section 1000, Title X, of the Revenue Act of 1918 (40 Stats. 1126). This section was considered by the Court in *Hecht* v. *Malley,* 265 U. S. 144 (1924), but the question here presented as to the measure of the tax was not presented or decided.

Under Section 1000 the tax on a domestic corporation is to be computed upon the *"fair average value of its capital stock for the preceding year ending June 30"*. The *shares* of stock of appellant were and are regularly dealt in on the New York Stock Exchange in substantial volume and had an established market price during the critical year. Appellant contends that these shares constituted the "capital stock" to be valued, and that the established market price is the most direct and persuasive evidence of the fair average value of the shares for the year. The Commissioner of Internal Revenue, however, measured the capital stock tax of appellant by the fair value of its *net assets* on December 31, 1919, giving no weight to the market value of the shares or to any facts except the value of the corporation's assets, and the Commissioner's action was approved below.

Statement of Case.

The appellant brought this action in the United States Court of Claims for the recovery of $69,798.07 additional capital stock tax and interest paid by it under protest for the taxable year ending June 30, 1921. The facts were stipulated. Before the case came to trial the Commissioner of Internal Revenue determined that $48,557.77 of the amount sued for should be refunded, and this was done. This action was then continued under amended pleadings as an action for the recovery of the unrefunded balance of $21,240.30. An amended statement of facts was agreed to by the parties. The Court below adopted the agreed facts as its findings of fact (omitting three exhibits) and there is no controversy as to the facts. Through error the Court below used the original stipulation of facts instead of the amended stipulation of facts as its findings. This mechanical error has been corrected by a stipulation printed in the transcript of record. The Court of Claims dismissed appellant's petition on the merits and filed a written opinion. This appeal is taken from that decision (Sec. 182, Judicial Code, pertaining to the Court of Claims, 36 Stats. 1142).

Since it has been necessary to print this brief before the transcript of record was printed the

references are to the findings of fact as numbered in the stipulation correcting the record.

The findings show the following facts:

The appellant was and is a domestic corporation engaged in the mining, milling and selling of copper and owning extensive deposits of low grade ore (Finding No. 2). For the taxable year ending June 30, 1921, it duly filed a capital stock tax return on form 707 prescribed by the Commissioner, setting forth information as to its assets and liabilities, sales of its shares of stock, its earnings, and the dividends paid. This report showed that during the critical year 537,938 shares of appellant's stock were bought and sold on the New York Stock Exchange at an average price of $22.067 per share. There were 1,577,179 shares of such stock outstanding during 1919 and 1920 and the value of such shares at $22.067 per share was $34,803,608.99. This was the amount reported by the appellant as the fair average value of its capital stock. The tax computed at $1 per $1,000 of such total value, amounting to $34,798, was duly paid (Findings 4 to 7).

The Commissioner of Internal Revenue refused to approve this determination of the tax. In February, 1922, he made an additional assessment of $69,107. This was based upon a determination of the *net fair value of the assets* owned by

the appellant on December 31, 1919. Appellant's capital stock tax return included as Exhibit A a statement of its assets and liabilities as required by the official form and a rider attached to the return specifically called attention to the fact that in said Exhibit A the mining property was included at $8,657,620.28, its book value based on *cost,* and that any valuations of such property for depletion purposes were omitted as immaterial. In determining the net fair value of the assets for the purposes of the additional assessment, the value of the mining property on December 31, 1919, was determined by the Commissioner by using its value as of March 1, 1913, theretofore determined by him for depletion purposes under the Income Tax Law ($93,678,-245.28),—a valuation as of such date less than that which the plaintiff had contended for—with an allowance for depletion sustained from March 1, 1913, to December 31, 1919, of $13,318,-384.31, resulting in a net value on December 31, 1919, for the mining property of $80,359,860.97, and in a net value for the total assets of $103,-910,409.07 (Finding 10). Appellant was notified of the additional assessment resulting from this change and the basis therefor by a letter from the Bureau of Internal Revenue dated February 23, 1922, which is set forth in Finding 11.

Appellant was required to pay and did pay

under protest the additional assessment of $69,107 with interest thereon of $691.07, and a claim for refund thereof was rejected in full on June 29, 1922 (Findings 14 and 15).

After the commencement of this action in the Court below the Commissioner of Internal Revenue reconsidered his decision on the claim for refund of the additional assessment of $69,107 and interest, and on November 9, 1923, refunded $48,077 of such additional tax and a proportionate part of the interest (Finding 16).

In making this refund the Commissioner adhered to his position that the capital stock tax should be based upon the net fair value of the Company's assets on December 31, 1913, and again adopted the excess of assets over liabilities as the fair value of the "capital stock". He modified his previous decision, however, by determining that the fair value of the mining property on December 31, 1919, was but $32,282,-993.56, and the total excess of assets over liabilities on that date but $55,833,541.66, a valuation less than the original valuation by $48,076,867.41. The Court below states in its opinion that this final valuation of the property was the 1913 valuation less an allowance for depletion from 1913 to 1919. It was in fact an entirely new valuation as of December 31, 1919 (Finding 16).

The appellant was advised of the basis for this

refund by a "Notice of adjustment of claim for refund" which is set forth in full in Finding 16.

The Commissioner of Internal Revenue at no time has determined, or purported to determine the "fair *average* value" of the capital stock of appellant. The amount finally determined by the Commissioner as the "fair value" of appellant's capital stock based directly and solely upon a valuation of the net corporate assets as of December 31, 1919, was $55,833,541.66. The only asset increased over the amount at which it was returned by the appellant was the mineral deposits. The amount reported by the appellant as the fair average value of its capital stock based on sales of shares thereof in substantial volume during the preceding year was $34,803,608.99. The tax attributable to the difference between these amounts is $21,030 which with $210.30 interest paid thereon is the full amount sued for.

Assignment of Errors.

1. The Court erred in dismissing appellant's petition and in refusing to grant the judgment demanded in said petition.

2. The Court erred in holding that the term "fair average value of its capital stock for the preceding year" as used in Section 1000 of the Revenue Act of 1918 means the value of the net assets of the corporation.

3. The Court erred in refusing to hold that the term "fair average value of its capital stock for the preceding year" as used in Section 1000 of the Revenue Act of 1918 means the value of the shares of capital stock of the corporation.

4. The Court erred in sustaining the assessment of capital stock tax made by the Commissioner of Internal Revenue in this case solely on the basis of the fair value of the net assets of the corporation.

5. The Court erred in refusing to hold that the capital stock tax of appellant should have been measured by the fair average value of its shares of capital stock for the preceding year.

6. The Court erred in refusing to hold that the fair average value of the shares of stock of appellant for the preceding year should be determined primarily by use of the sales of such shares dur-

ing such year in substantial volume on the open market.

7. The Court erred in holding that the Commissioner of Internal Revenue could properly disregard entirely the sales of appellant's shares in substantial volume on the open market during the preceding year and determine the capital stock tax of appellant solely on the basis of the fair value of appellant's net assets on a single date.

The Statute.

The provisions of Section 1000 of the Revenue Act of 1918 are as follows:

> "Sec. 1000. (*a*) That on and after July 1, 1918, in lieu of the tax imposed by the first subdivision of section 407 of the Revenue Act of 1916—
>
> (1) Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1,000 of so much of the fair average value of its capital stock for the preceding year ending June 30 as is in excess of $5,000. In estimating the value of capital stock the surplus and undivided profits shall be included;
>
> (2) Every foreign corporation shall pay annually a special excise tax with respect to carrying on or doing business in the United States, equivalent to $1 for each $1,000 of the average amount of capital employed in

the transaction of its business in the United States during the preceding year ending June thirtieth.

(*b*) In computing the tax in the case of insurance companies such deposits and reserve funds as they are required by law or contract to maintain or hold for the protection of or payment to or apportionment among policyholders shall not be included.

(*c*) The taxes imposed by this section shall not apply in any year to any corporation which was not engaged in business (or in the case of a foreign corporation not engaged in business in the United States) during the preceding year ending June 30, nor to any corporation enumerated in Section 231. The taxes imposed by this section shall apply to mutual insurance companies, and in the case of every such domestic company the tax shall be equivalent to $1 for each $1,000 of the excess over $5,000 of the sum of its surplus or contingent reserves maintained for the general use of the business and any reserves the net additions to which are included in net income under the provisions of Title II, as of the close of the preceding accounting period used by such company for purposes of making its income tax return: *Provided,* That in the case of a foreign mutual insurance company the tax shall be equivalent to $1 for each $1,000 of the same proportion of the sum of such surplus and reserves, which the reserve fund upon business transacted within the United States is of the total

reserve upon all business transacted, as of the close of the preceding accounting period used by such company for purposes of making its income tax return.

(*d*) Section 257 shall apply to all returns filed with the Commissioner for purposes of the tax imposed by this section."

The Issues.

The appellant contends that the term "fair average value of its capital stock for the preceding year" used in paragraph (1) subdivision (*a*) above, refers to the value of the shares of stock; that the average value of such shares for the year is the "business and financial reality" by which the tax is measured; that the fair average value of such shares of stock for the preceding year is to be determined here just as it would be for any other purpose, on the basis of all the available evidence; that while the Commissioner has wide discretion as to the evidence of value to be used in a particular case, sales of shares throughout the year in reasonable volume furnish the best evidence of the fair average value of the shares. Since the shares are property wholly different from the net assets of the corporation and having a different value, the assessment in this case, based solely upon corporate asset values, is incorrect. The fair average value of the shares for the critical year is here directly established by numerous sales

thereof, and appellant should therefore have judgment for the full amount sued for.

The Government's position, if the same here as in lower courts, is that the term "capital stock" must be given a broad, flexible meaning defined below as "the entire potentiality of the corporation to profit by the exercise of its corporate franchise", and that under this broad meaning the Commissioner is free to use asset values as the basis of the tax, ignoring share values altogether, as in the present case, or to use values based on earnings or on sales of shares, as in *Central Union Trust Co.* v. *Edwards,* 287 Fed. 324 (1923). The Court below, while adverting to this broad meaning with apparent approval, in fact held that the term "capital stock" meant net assets, and not the shares of stock or a value based on earnings.

The appellant denies that "capital stock" as here used means net assets; it denies that "capital stock" as used in the statute has any unusual meaning, or can in effect mean either shares or assets as the Commissioner may elect, or that the meaning of the term and the tests of value are so vague and flexible as to permit the Commissioner to make whatever assessment may seem most favorable to the Government. Appellant's position is supported by reference to the text of the statute, its legislative history, its general nature and purposes, and administrative and constitutional considerations.

Argument.

The question of statutory construction here raised is as to the meaning to be given to the words "fair average value of its capital stock for the preceding year" as used in Section 1000 of the Revenue Act of 1918 (*supra,* p. 9). The term "capital stock" has no fixed significance and must be construed in a particular statute by reference to the context, the nature and purpose of the statute, its history and other aids to construction. The term may, according to the context, refer either to capital paid in, to shares of stock, or to gross assets, or to net assets.

Cook on Corporations, Vol. I, Section 8, page 46, 8th Ed.

Corpus Juris, Vol. 9, page 1280.

Fletcher Cyc. Corporations, Vol. 5, page 5584.

Tennessee v. *Whitworth,* 117 U. S. 129 (1886).

Powers v. *Detroit & Grand Haven Rwy.,* 201 U. S. 543 (1906).

Hood Rubber Co. v. *Commonwealth,* 238 Mass. 369 (1921).

Central Union Trust Co. v. *Edwards,* 287 Fed. 324 (1923).

The shares of stock of a corporation and the capital or assets of a corporation are, of course, entirely different things, and the value of the shares of stock is different from and bears no fixed or necessary relation to the value of the corporate assets. For this reason the market value of the shares of the capital stock does not establish the value of the corporate assets or *vice versa.*

Van Allen v. *The Assessors,* 3 Wall. 573 (1865).

Des Moines Natl. Bank v. *Fairweather, et al.,* 263 U. S. 103 (1923).

Commonwealth v. *Hamilton Mfg. Co.,* 12 Allen 298 (1866).

Commonwealth v. *Cary Improvement Co.,* 98 Mass. 19 (1867).

National Bank of Commerce v. *New Bedford,* 155 Mass. 313 (1892).

National Bank of Commerce v. *New Bedford,* 175 Mass. 257 (1900).

People ex rel. Union Trust Co. v. *Coleman,* 126 N. Y. 433 (1891).

Schley v. *Montgomery County,* 106 Md. 407 (1907).

Pullman's Palace Car Co. v. *Central Transportation Co.,* 171 U. S. 138 (1898).

The distinction takes point, in the instant case, by comparison of the average value of the shares of stock as determined by the market sales ($34,803,608.99) with the fair value of the corporate assets as now found by the commissioner ($55,833,541.66) and as originally found by him ($103,910,409.07). It is therefore necessary to determine whether the statutory term "capital stock" is used in the sense of shares of stock or in some other sense.

I.

The statutory measure of the tax is the fair average value of the shares of capital stock, not the value of the corporate property.

A. The text of Section 1000 shows that the phrase "fair average value of its capital stock for the preceding year" is used in the sense of the value of shares of capital stock, not in the sense of the value of property and business.

(1) Share values can form the basis of an "average for the preceding year", as contemplated by the statute; assets or property values do not form a practicable basis for such an average.

The value to be ascertained is "the fair *average* value * * * *for the preceding year ending June 30.*" The statute clearly contemplates the use of a series of values during the specified year which can be mathematically averaged to obtain the mean. "Average" when used in connection with *"value"* for a *"year"* must refer to a mathematical average of values during the year.

> "As ordinarily employed the word (average) is not open to construction. It is the mean between two or more quantities or measures and is usually mathematically expressed by the quotient of the sum of the quantities, measures or numbers which are being compared, divided by the number of items used in the comparison."

Long v. *Ottumwa Railway & Light Co.*, 162 Ia. 11, 28 (1913).

See also:

Swift & Co. v. *Board of Assessors,* 115 La. 321 (1905).

Hersh v. *The Northern Central Rwy. Co.,* 74 Pa. 181 (1873).

Central Granaries Co. v. *Lancaster County,* 77 Neb. 311, 326 (1906).

Jones v. *Marrs,* 263 S. W. 570 (Tex. 1924).

6 C. J. 873

The assets of a corporation, especially fixed assets such as plant or mineral reserves, are not ordinarily bought and sold, and are not appraised or valued in any way, except at rare intervals and at considerable expense. There could hardly be any fair *average* value for a particular year of the business and property of a corporation as an entirety because it would not be practicable to get a series of valuation figures to average. The Treasury recognizes this, and where it uses assets as the measure of the tax, it uses the most recent balance sheet of the taxpayer, as it did in this case, a proceeding which gives absolutely no significance to the word "average". The fair value of this company's assets on December 31, 1919, obviously is not a fair *average* value of anything.

The Treasury Regulations specifically provide:

> "Attempts to average the assets as a means of estimating the fair average value of the capital stock are not permitted."
>
> *Article 15, Regulations 64—1924 Ed.*

In substance the Treasury reads "average" out of the statute. What the Commissioner purported to determine in this case was "fair value" on a particular date and not "fair *average* value for the preceding year", as appears from the findings of fact. But this word "average" which the Treasury disregards is a most important key to the meaning of the statute here involved. The thing to be valued under the statute is something having different values at different times which can be ascertained and averaged, and that thing is "the capital stock divided into shares."

In contrast to the lack of frequent valuations of assets of domestic corporations, the shares of stock of the appellant and of a very large number of domestic corporations, including most of the largest, are freely bought and sold from day to day during the year in large volume, and such sales are recorded in a form convenient and readily accessible. It is practicable in this case and in a great many cases to get "the fair *average* value * * * for the *preceding year* ending June 30" of the shares of stock direct from actual

sales of such stock during such year. In some cases, it is true, there are no sales and there the fair average value of the shares would have to be obtained from secondary evidence as to the assets and earnings of the corporation and all other relevant circumstances.

The Court below did not attempt to show that the word "average" had been given any significance in making this assessment. It followed the Treasury Department in reading the word "average" out of the statute, and in construing the statute as if that word had not been used. Its only definite statement as to the meaning of "average" is that "average" indicates "apportionment", a statement which seems meaningless in view of the court's decision requiring a valuation of net assets on one date only. A valuation as of a single date certainly does not involve "apportionment". The court also seems to have thought that "average" might be interpreted as meaning the same as "fair". Such a construction ignores the mandate that the *"average"* be *"for the preceding year"* and deprives "average" of any independent significance. Both "fair" and "average" are given their ordinary meaning if "capital stock" means shares.

The tax imposed by Section 1000 on foreign corporations is measured by the *"average amount* of capital employed in the transaction of its busi-

ness in the United States". Here the Treasury does not disregard the word "average" but carefully provides how the averaging shall be done (*Art. 27, Regulations 64-1924 Ed.*). The tax on foreign corporations as administered involves no question of the valuation of assets but is based upon a proportionate part of the capital, surplus and undivided profits, a figure taken from the books (*Art. 24, Regulations 64-1924 Ed.*), or by the physical assets in the United States at book values, less a proportionate part of the liabilities. (*Form 708, 1925 Return*—Capital Stock Tax.)

(2) That "capital stock", as used in subdivision (1) of Section 1000 (a) is used in the sense of shares of stock, is established by the contrasting use of the word "capital" in subdivision (2).

A domestic corporation is taxed on the basis of "the fair average *value* of its *capital stock*" and a foreign corporation on the basis of "the average *amount* of *capital* employed * * * in the United States". To interpret "capital stock" as meaning corporate assets is to say that Congress used "capital stock" in subdivision (1) in the same sense as the very different phrase "capital employed" in subdivision (2).

In the case of *Hecht* v. *Malley,* 265 U. S. 144 (1924), this Court said that a construction of the capital stock tax on domestic corporations as a tax measured by assets draws this tax into har-

mony with the tax on foreign corporations measured by "capital" employed in the United States. But such harmony is only to be attained by holding that very different phrases used in closely associated clauses of the statute have the same meaning.

The statements of the Court in *Hecht* v. *Malley* as to the measure of the capital stock tax can not be deemed to decide the issue here raised for that issue was not involved and was not presented to the Court. The Court there held that three Massachusetts trusts were subject to the 1918 capital stock tax. Each of these trusts had transferable certificates similar to shares of capital stock. The tax assessed in each case had been based upon the value of the net assets of the trust. There was, however, no dispute as to the amount of the tax or the measure used; what each trust claimed was complete exemption.

The Crocker Association (one of the three trusts) based its claim for exemption on the ground that it had no "capital stock" because its certificates of beneficial interest had no stated or par value but were merely for 96,000ths of the beneficial interest in the organization, and because it had no separate account for "capital stock" or "capital" on its books. It claimed that there was no liability to the capital stock tax unless there was a designated share capital fixed in the articles or on the books. In rejecting this contention, this

Court adopted the argument made by the Government in its brief and said at p. 163:

> "We think that in the Act of 1918, in which the tax upon an association is based upon the average value of its 'capital stock,' including surplus and undivided profits, these words are not to be given a technical meaning, but should be interpreted, in their entirety, and, *in the absence of a fixed share capital,* as equivalent to the capital invested in the business, that is, the net value of the property owned by the association and used in its business. As was said by the Circuit Court of Appeals, the phrase in the statute as to " 'including surplus and undivided profits' puts beyond doubt the question of the congressional intent to measure this tax by business and financial realties, not by bookkeeping forms or mere names." And this construction is in harmony with the provision as to the excise tax on a foreign association, which is fixed upon the value 'of the capital actually invested in the transaction of its business in the United States.'
>
> We therefore conclude that the Crocker Association was also subject to the tax, and that this was properly measured by the Collector by the net value of its property—no question being made as to the correctness of his valuation." (Italics ours.)

These statements in terms apply only *"in the absence of a fixed share capital"* and hence are

not directly controlling here. The Court held that nothing turns on the purely formal distinction between no par stock and par value stock. The association admitted that if its articles stated a definite capital, and its books showed a capital account and a separate undivided profits and surplus account it would have a "capital stock" and be taxable on its capital, surplus and undivided profits. The Court refused to exempt the association because of the way in which its accounts were kept and the absence of a stated capital in the trust agreement or elsewhere. The Court naturally adverted to the use of assets values as the measure of the tax because that was the measure used in the case with the concurrence of both parties, and the contention now made that "capital stock" means shares was not urged or considered. The Court's decision would have been precisely the same if share values had been used as the measure, because the Crocker Association had shares as well as assets.

The contrast in the statute here under consideration between "fair average value of its capital stock" for domestic corporations and "average amount of capital employed" for foreign corporations is striking and an important indication of the Congressional intent. This contrast is emphasized by the statuatory requirement as to "capital stock", that there be a determination of its "fair average *value*"; but as to "capital", the

statute requires a determination of its "average *amount*".

This method of construing the term "capital stock" on the basis of its use in contrast to a term referring to property was employed by this Court in *Tennessee* v. *Whitworth,* 117 U. S. 129 (1886). In that case the State of Tennessee petitioned for a writ of mandamus to compel the defendant Whitworth, a tax collector, to assess for taxation certain shares of stock in a Railway Company. The defendant alleged that the shares of stock of the Railway Company were exempt from taxation under a charter from the State which provided that:

> *"The capital stock of said company shall be forever exempt from taxation,* and the road with all its fixtures and appurtenances, including workshops, warehouses, and vehicles of transportation, shall be exempt from taxation for the period of twenty years from the completion of the road, and no longer." (Italics ours.)

The Court held that under this charter provision the phrase "capital stock" referred to the shares of stock. The "capital stock" was exempt from taxation forever, but the property or capital of the Railroad Company was exempt for but twenty years. This contrast made it clear that the perpetual exemption of "capital stock" applied not to the property but to the shares of stock. Mr.

Chief Justice Waite for the Court said, at page 138:

"As was shown in *Railroad Companies* v. *Gaines,* above cited, the words 'capital stock of said company', and the words 'the road with all its fixtures and appurtenances', were used in the charter to describe different things. The 'capital', which upon the payment by the subscribers belonged to the corporation, has been converted into the railroad and its appurtenances, and it had no separate existence as a taxable thing after the road was built and equipped. But the 'capital stock' divided into shares, subscribed and paid for by the persons to whom the shares were originally issued, still has, and was by the charter intended to have, an existence separate and distinct from the property into which the money paid for it has been converted, * * * The charter exempted the stock from taxation clearly because the property which represented the stock had been put in its place as a taxable thing. The exemption is of the thing called the 'capital stock' divided into shares."

In *Railroad Companies* v. *Gaines,* 97 U. S. 697 (1878), the Court had held that the property of the Railroad Companies was not exempt from taxation forever under a charter provision reading exactly the same as the one quoted above. The Court said that it was clear that the property was to be taxable at the end of twenty years, so that whatever was perpetually exempt as "capital

stock" it was not the property of the corporation which was so exempt.

Since only values attributable to the United States were to be taxed in the case of foreign corporations, it was natural that Congress should adopt for them a measure based upon assets in the United States, rather than the measure of share values adopted for domestic corporations. The Treasury itself recognizes that the measure of the tax for domestic corporations is different from that for foreign corporations, that "average amount of capital employed" does not mean the same as "fair average value of capital stock" (*Art. 26, Regulations 64—1924 Ed.*).

The only construction which will give an effect to the contrast between the phrases used in Section 1000, read together as they must be, is that contended for by the appellant. The distinction must be that between corporate shares and corporate assets.

(3) The special statutory provisions as to mutual insurance companies support appellant's position.

The provisions of Section 1000 of the 1918 Act as to mutual insurance companies, which, of course, have no shares of stock, strongly support appellant's construction of the Statute. Section 1000 provides in part as follows:

> "The taxes imposed by this section shall apply to mutual insurance companies, and in the case of every such domestic company the

> tax shall be equivalent to $1 for each $1,000 of the excess over $5,000 of the sum of its surplus or contingent reserves maintained for the general use of the business and any reserves the net additions to which are included in net income under the provisions of Title II, as of the close of the preceding accounting period used by such company for purposes of making its income tax return; *Provided, That* in the case of a foreign mutual insurance company the tax shall be equivalent to $1 for each $1,000 of the same proportion of the sum of such surplus and reserves, which the reserve fund upon business transacted within the United States is of the total reserve upon all business transacted, as of the close of the preceding accounting period used by such company for purposes of making its income tax return."

The tax of domestic mutual insurance companies is not based on "capital stock" at all or on any average value over a period but by virtue of this special provision is based on reserves measuring the excess of assets over certain liabilities on a specified date. This special provision was inserted to take care of a special class of cases where the ordinary measure of the tax, the value of the shares of stock, obviously could not be used because the company had no shares of stock. If Congress intended that the tax on domestic corporations should be based upon a valuation of assets, this special provision as to domestic mutual insurance companies was wholly unnecessary and surplusage.

(4) The statutory reference to "surplus and undivided profits" is consistent with appellant's view.

The last sentence of subdivision (1) of paragraph (*a*) of Section 1000 reads:

> "In estimating the value of capital stock the surplus and undivided profits shall be included."

This sentence is referred to in *Hecht* v. *Malley,* (*supra*) and is strongly relied upon by the Court below. The significance given to this sentence seems to leave out of account its relation to the rest of the statute, the subject matter of the statute and the origin of the quoted sentence.

The sentence is a survival from the Bankers Tax Law of October 22, 1914 (38 Stats. 750), a statute imposing a tax on bankers, and differing fundamentally from the Capital Stock Tax. The Bankers Tax was on "capital employed in banking", and in order to show clearly that accumulated earnings as well as capital originally paid in were to be taken into account, a phrase was incorporated in the statute reading:

> "and in estimating capital surplus and undivided profits shall be included."

This law was expressly stated to be a tax based on capital, surplus and undivided profits, that is, on assets. In drafting the 1916 Revenue Bill, it was first proposed to continue this tax on capital

employed in banking. In lieu of this, however, a tax was imposed on all corporations instead of merely on bankers, and the measure of the tax was changed from "capital employed in banking" to "fair average value of its capital stock". This change in language unmistakably showed that the new tax was on something other than assets, a fact which the Treasury charged with the administration of both laws recognized in the first capital stock tax regulations. (*Art. 6, Reg. 38*). The substantial change in language is of controlling importance; the mere continuation of the reference to surplus and undivided profits is of little significance. The 1918 Revenue Act here under consideration merely followed the language of the 1916 Act.

The court below, in its opinion, wholly disregarded the contrast between "capital stock" and "capital employed"—a major difference between the Bankers Tax and the Capital Stock Tax—read the word "average" out of the statute, and gave controlling significance to the incidental continuation of the reference to surplus and undivided profits.

The situation in the present case is entirely different from that in *Home Savings Bank* v. *Des Moines*, 205 U. S. 503 (1907) cited below. There the tax was clearly a state *property* tax on the corporation, the statute specifically called for a statement of assets and liabilities and provided that "the

property of such corporation shall not be otherwise assessed". There a statutory reference to capital, surplus and undivided profits assisted the Court in determining that the tax nominally on shares of stock was in fact on the corporation's property. But here the tax is not a property tax and could not be imposed as such without apportionment, but is an excise tax which might properly be measured by the value of the shares. The *Home Savings Bank* case is, in fact, but one of a large number of cases dealing with *direct property* taxes imposed by the states on corporations. The Courts have often held that the nature of the tax as a property tax showed that the term "capital stock" as used in such statutes meant the corporate assets.

> *Pacific Hotel Co.* v. *Lieb,* 83 Illinois, 602 (1876);
> *Henderson Bridge Co.* v. *Commonwealth,* 99 Kentucky 623 (1895);
> *People* v. *Coleman,* 126 N. Y. 433 (1891).

But such decisions are not in point where, as in this case, the tax is an *excise* tax and not a direct property tax, and where the tax is imposed by Congress which has no power to levy an unapportioned direct tax. (*See Infra p. 55.*)

The Government's contention that the tax is measured by the net value of the enterprise is not

supported by this statutory reference to surplus and undivided profits. "Surplus and undivided profits" ordinarily mean figures taken from the accounts of the corporation and appearing on its books. "Surplus and undivided profits" are ordinarily accumulated earnings and income as determined by a closing of the books of account at the close of a fiscal period.

> *Douglas* v. *Edwards*, 298 Fed. 229, 241, (1924).

They do not ordinarily include unrealized appreciation, appraised value of assets, developed good will, going value, and other possible elements of value not entered on the books, which the Government is attempting to include in the measure of the tax. "Surplus and undivided profits" do not include such unrealized appreciation as cannot be earned until future years and which is no part of the profits until realized in the future and which therefore cannot be any part of the surplus and undivided profits "for the preceding year".

> *Sexton* v. *C. L. Percival Co.*, 177 N. W. 83, 86 (Ia. 1920).
>
> *T. P. Cochrane* v. *Interstate Packing Co.*, 139 Minn. 452 (1918).

Even where appreciation has been taken up on the corporation's books and the surplus correspondingly increased, accountants require it to be

specially designated as a "surplus arising from a revaluation". The Courts generally refuse to recognize such unrealized appreciation as "surplus and undivided profits" available for dividends.

> *Kingston* v. *Home Life Insurance Co. of America*, 101 Atl. 898 (Del. 1917).
> *Southern California Home Builders* v. *Young*, 188 Pac 586 (Cal. App. 1920).

Of course, unrealized appreciation even though entered on the books, is not income and hence not a part of "undivided profits".

> *Baldwin Locomotive Works* v. *McCoach*, 221 Fed. 59 (1915).

In holding that the term "paid in or earned surplus" excluded unrealized appreciation this Court said:

> "The principal line of demarcation—that based on actual costs, excluding estimated appreciation—finds reasonable support upon grounds of both theory and practice, in addition to the important consideration of convenience in administration, already adverted to. There is a logical incongruity in entering upon the books of a corporation as the capital value of property acquired for permanent employment in its business and still retained for that purpose, a sum corresponding not to its cost but to what probably might be realized by sale in the market. It is not merely

that the market value has not been realized or tested by sale made, but that sale cannot be made without abandoning the very purpose for which the property is held, involving a withdrawal from business so far as that particular property is concerned."

La Belle Iron Works v. *United States,* 256 U. S. 377, 393 (1921).

The reference to surplus and undivided profits is given ample scope and significance under appellant's construction of the statute. When the fair average value of the shares of stock is determined from sales, the corporate surplus and undivided profits are fully taken into account and are included in the estimated value, for the market value of the shares reflects and includes all the elements of value in the shares as appraised by the public. This is the view taken by the Commissioner of Internal Revenue who asserts the right to measure the Capital Stock Tax by share values, if that yields a higher tax than the basis of net assets. The present regulations (Regulations 64—1924 Ed.) provide as follows:

"Article 16. *Surplus and undivided profits.* —The surplus and undivided profits of a corporation must be included in estimating the fair average value of its capital stock. If the fair average value be determined from the book value, the surplus and undivided profits are included in the assets; if from

> sales, they are necessarily a factor in determining the market price; and, if from net income, they are reflected to a greater or less extent in the earnings."

The Commissioner thus finds no difficulty in harmonizing the reference to surplus and undivided profits with the use of share values as a measure of the tax. The surplus and undivided profits are, of course, factors in determining the market price of the shares when that is below asset values, as well as when that is more than asset values.

In cases where there are no sales of shares, surplus and undivided profits are, of course, factors to be taken into account in estimating the fair average value of the shares. The phrase also serves the purpose of helping to show that it is not the par value of the shares, but their actual value, whether more or less than par, that is to be used. The construction of the statute advanced by appellant thus gives to this sentence a reasonable consideration and significance and gives to it the amount of weight to which it is entitled in view of its origin.

This construction of the statute, it will be noted, was the construction adopted by the Treasury contemporaneously with the passage of the first capital stock tax law in the Regulations drafted and approved by the officials who were then administering the Bankers Tax imposed by the law of 1914 from which the reference to surplus and undivided profits was taken. Article 6

of Regulations No. 38 (1916) provided in part as follows:

> " 'Cases in which fair average value of stock shall be estimated.
>
> '(*c*) Case III.—*If Case I and Case II can not be applied, viz.,* the stock is not listed on any exchange, and no actual sales have been made during the preceding fiscal year, or if the price at which sales have been made is not known to the officer making the return the fair average value of the capital stock shall be estimated, and the surplus and undivided profits for the preceding fiscal year will be taken into consideration as required by the statute, as well as the nature of the business, its earning capacity and average dividends paid, or profits earned during the preceding five years.' "

The above Regulation was in force until August 1918 and the payments of capital stock taxes made in January and July 1917 were computed on this basis.

The special provision of subdivision (*b*) of Section 1000 that in the case of insurance companies such deposits and reserve funds as they are required by law or contract to maintain or hold for the policyholders shall not be included, is a provision complementary to the general reference to surplus and undivided profits, and merely recognizes that such deposits and reserve funds should in fairness be treated as liabilities and not as a part of the surplus.

(5) The statutory use of the word "estimating" does not indicate that what is to be estimated is the value of the assets rather than the value of the shares.

The court below relied somewhat upon the use of the word "estimating" in the statute, and apparently thought that this excluded reference to the market value of the shares since "no difficulties present themselves in ascertaining the real, mathematical, average, market value of the same". But "estimating" as here used means no more than "determining" or "valuing".

The word "estimating" was first used in this connection in the Bankers' Tax Law (Act of October 22, 1914, 38 Stats. 750), and is a part of the sentence carried over bodily from that statute. The Bankers' Tax Law was readily and simply applied to capital, surplus and undivided profits, figures taken from the books, although that statute provided that "in estimating capital surplus and undivided profits shall be included". The presence of the word "estimating" was never thought to require the adoption of some difficult and uncertain measure of taxation involving valuations and not susceptible of a check.

The logical conclusion of the argument of the Court below seems to be that where the measure of the tax is to be estimated, any test easily applied and leading to a definite and certain result must be excluded from consideration because it involves no difficulties or uncertainties. In con-

struing this tax statute, however, this Court undoubtedly will adopt a construction which will so far as possible make the amount of the tax readily and definitely ascertainable by both the taxpayer and the Government.

With respect to this statute, no matter how simple the test may be, there will be ample room for the exercise of judgment. In measuring the tax by the value of the shares of stock, the Commissioner will find it easy to estimate the fair average value in some cases where there have been many sales and will find it more difficult to estimate such value in other cases where there have been no sales or few sales, but in every case the fair average value of the shares of capital stock will be *estimated* on the basis of all the available data. This is exactly what was contemplated by Congress. The Chairman of the Committee in charge of the 1916 Revenue Bill (Mr. Kitchin) said as to the measure of the capital stock tax, "When it (capital stock) has a market value, it would be the market value; but some stocks have no market value, and they would have to ascertain what the fair actual value is." (*See extensive quotation, infra p. 42.*)

The case of *Powers* v. *Detroit & Grand Haven Railway Company,* 201 U. S. 543 (1906), cited below, involved a charter provision imposing an annual tax on "the capital stock of said Company paid in", and the Court held that this clearly referred to the property which the corporation had received and presumably held. In

stating that the word "estimated", as there used, involved valuation rather than mathematical apportionment, the Court is apparently contrasting a valuation of assets with the par value of the shares of stock. There is nothing in the language used to indicate that the Court meant that a valuation of shares was any less an estimate than a valuation of assets.

B. The legislative history of this statute and of statutes in pari materia preceding it shows that Congress intended that the measure of the tax on domestic corporations should be the fair average value of the shares of stock, and not the value of corporate assets.

Resort to legislative history is fully warranted in cases such as this, where the meaning of the statute is not entirely clear from its words.

> *Church of the Holy Trinity* v. *United States,* 143 U. S. 457 (1892);
> *United States* v. *St. Paul M. & M. Ry. Co.,* 247 U. S. 310 (1918).

(1) Tax on capital of Bankers—1914.

The first general capital stock tax law was preceded by the Act of October 22, 1914 (38 Stats. 750), which in Section 3 provided for a tax on bankers as follows:

> "Bankers shall pay $1 for each $1,000 of *capital used or employed,* and in *estimating* capital *surplus and undivided profits* shall be

> included. The amount of such annual tax shall in all cases be computed on the basis of the capital, surplus, and undivided profits for the preceding fiscal year." (Italics ours.)

A bankers' tax in similar language had been imposed by the Act of June 13, 1898 (30 Stats. 448). It was settled that the statutory measure of these taxes was the capital, surplus and undivided profits, *i. e.*, the net assets, employed in banking.

> *Leather Manufacturers' National Bank* v. *Treat*, 128 Fed. 262 (1904); Certiorari denied, 198 U. S. 584 (1905).

Apparently no questions as to valuation of assets arose in administering these statutes.

(2) First General Capital Stock Tax—1916.

The bankers' tax remained in force until January 1, 1917. Its place was taken by a capital stock tax imposed upon all corporations by Section 407 of the Revenue Act of 1916 (39 Stats. 789), the first general federal capital stock tax law. This tax was measured by—

> "the fair value of its *capital stock* and in estimating the value of capital stock the surplus and undivided profits shall be included: * * * The amount of such annual tax shall in all cases be computed on the basis of the *fair average value* of the *capital stock for the preceding year";* (Italics ours.)

The bankers tax was measured by "capital used or employed" and had been held to be a tax measured by the amount of the property employed in banking. The new tax which was adopted in the Revenue Act of 1916 applied to all corporations, and in the case of domestic corporations was based on the "fair average value" of the "capital stock" rather than on "capital used or employed". In the case of foreign corporations it was based on the "capital actually invested in the transaction of its business in the United States" instead of on "capital used or employed".

In changing the tax from one on banks to one on all corporations, it is clear that Congress found it advisable to change the measure of the tax. The assets of banks consisted largely of cash, loans and securities. Banks kept accurate books according to established and uniform methods under strict State or Federal supervision. Hence they were readily taxed on capital, surplus and undivided profits employed in banking, figures taken from the books and involving no questions of valuation. There was no such uniformity in the character of the assets or the methods of bookkeeping of corporations generally. Congress recognized that all corporations could not be taxed with uniformity on the basis of amount of capital, which had been used in taxing banks, and adopted as the measure for the new and more comprehensive tax on all domestic corporations

the "fair average value" of the "capital stock". This change in the language describing the measure of the tax on domestic corporations clearly shows an intent to change from the earlier basis, property to the basis, shares of stock.

If Congress desired to include property, whether or not used or employed, that would have been done by dropping the words "used or employed" and retaining the word "capital". If Congress desired to include assets such as developed good will or unrealized appreciation in addition to the assets ordinarily included under the phrase "capital, surplus and undivided profits", it would have made this important change clear by using some phrase such as "the fair market value of the net assets". The change from "capital" to "capital stock" was not made to change the kind of *property* which was to be included in the measure of the tax but was made for the purpose of showing that *share value*, rather than any valuation of assets, was to be the measure of the new tax on domestic corporations.

Congress so understood the matter. In the debate on the floor of the House of Representatives just prior to the passage of this Act a discussion took place with reference to the capital stock tax between Mr. Kitchin, who was Chairman of the Ways and Means Committee and in charge of the Bill, and other members which is very help-

ful in the construction of the statute. The discussion was as follows:

> Mr. Denison: The Senate amendment taxes the capital stock and undivided profits.
>
> Mr. Kitchin: We fixed it at the fair value of the capital stock.
>
> Mr. Denison: The effect of the amendment as insisted upon by the House managers will be to increase the tax, generally speaking?
>
> Mr. Kitchin: No; to decrease the tax. The Senate amendment had the tax on the capital stock, surplus, and undivided profits —that is, the par value of the capital stock. We have put a tax of 50 cents a thousand upon the fair average value of the capital stock.
>
> Mr. Denison: *That means the market value?*
>
> Mr. Kitchin: *When it has a market value, it would be the market value; but some stocks have no market value, and they would have to ascertain what the fair actual value is.*
>
> Mr. Denison: Does not the gentleman think that ordinarily the market value of bank stock is far greater than the par value of the capital stock with the surplus added?
>
> Mr. Kitchin: Yes; and they would take that into consideration. They would get the actual value, and the provision declares they can consider the surplus and undivided profit in ascertaining that value. The earnings would also be considered.

Mr. Denison: The result will be that all banks will pay their regular income tax and then this surtax of 50 cents per thousand on the actual value of the capital stock?

Mr. Kitchin: Yes; and all other corporations. The bill as reported to the House had it $1 on the capital stock and surplus and undivided profits, and confined it to banks. This is 50 cents per thousand on the fair value only of the capital stock and applies to all corporations.

* * * * *

Mr. Mann: Mr. Speaker, in reference to that tax of 50 cents a thousand on the capital stock, I understood the gentleman to say that it would be 50 cents a thousand upon the fair market value?

Mr. Kitchin: It reads, "The amount of such annual tax shall in all cases be computed on the basis of the fair average value of the capital stock for the preceding year."

Mr. Mann: Who determines that?

Mr. Kitchin: The Treasury Department determines that, just as it would if we had put it the actual value. It would have to make investigation and determine the value.

Mr. Mann: Of course, it is a very simple matter to determine what the capital stock and surplus, and so forth, is, and *it may be a simple matter to determine what the fair average value is, which, I take it, is the fair market value, where there is a market.*

Mr. Kitchin: *Yes.*

Mr. Mann: *Is that to be determined as of*

a particular date, or the fair value for the year?

Mr. Kitchin: *It is a fair average value for the preceding year.*

Mr. Mann: *I would think it would take considerable figuring to find out the market value of some of the stock.*

Mr. Kitchin: *I imagine they would take a day or two in each month of the year—say the first day in the month and the last—and average it in that way; or, as the gentleman from Pennsylvania* (Mr. Kreider) *suggests, as is done by many corporations, the highest and lowest value during the year would be taken and divide it by two to get the average or the highest and lowest in each month, and from this get the average.* It would be more difficult than if we had said the par value, but that would not be just, for some stocks of par value of 100 are not worth 20.

Mr. Mann: These people must make a return in the first instance?

Mr. Kitchin: Yes.

Mr. Mann: I take it that the Treasury Department would not fix the value of the stock before the return is made?

Mr. Kitchin: They make a return first, and they swear what the fair average value of the stock was for the preceding year. Of course, if the Department has any reason to suspect them, it would make them give it more particularly and in detail.

Mr. Mann: This of course will not tax the indebtedness?

Mr. Kitchin: Oh, no, this will not. The Finance Committee of the Senate had it on the capital. Then they had it on the capital stock, surplus and undivided profits, and we now have it on the fair average value of the capital stock.

> (Congressional Record—House, Sept. 7, 1916, 64th Congress, 1st Session, Vol. 53, Part 13, page 14118.) (Italics ours).

Every word of this debate indicates that the shares were to be valued at their market value or actual value. Any idea that the tax was to be based upon capital was explicitly denied. This discussion cannot be dismissed as an exposition of opinion as to a detail of administration for it clearly shows that reference to the market value of the shares was thought to be the primary method of valuing the capital stock.

The court below seemed to think that because the 1914 Bankers Tax was measured by assets, the 1916 Capital Stock Tax which supplemented it must also be on assets. But the substantial differences in language, resulting from differences in the scope of the two statutes, make any such reasoning inadmissible. The logical presumption is that in changing the language Congress intended to change the measure.

A comparison of the language of Section 407

of the Revenue Act of 1916 with that of Section 1000 of the Revenue Act of 1918 here involved, will show that the two statutes levy the capital stock tax on exactly the same basis. The legislative history of Section 407 thus helps to show the meaning of Section 1000 of the Revenue Act of 1918.

(c) Capital Stock Tax—1918.

The capital stock tax adopted in the Revenue Act of 1916 was replaced as of July 1, 1918, by Section 1000 of the Revenue Act of 1918 adopted February 24, 1919, the statute here under discussion. Section 1000 of the Revenue Act of 1918 reads in part as follows:

> "Sec. 1000. (*a*)
>
> "(1) Every domestic corporation shall pay annually a special excise tax with respect to carrying on or doing business, equivalent to $1 for each $1,000 of so much of the *fair average value of its capital stock* for the preceding year ending June 30 as is in excess of $5,000. In estimating the value of capital stock the surplus and undivided profits shall be included;" (Italics ours.)

This language appeared in the 1918 Revenue Bill as passed by the House. The Senate amended this section of the House Bill so that Paragraph (1) read as follows:

> "Every domestic corporation shall pay annually a special excise tax with respect to

carrying on or doing business, equivalent to $1 for each $1,000 of the excess over $5,000 of the *amount of its net assets* shown by its books as of the close of the preceding annual period used by the corporation for purposes of making its income tax return; but if the corporation made no such return then of the excess over $5,000 of the amount of its net assets shown by its books as of the 30th day of June preceding." (Italics ours.)

(H. R. 12863, 65th Congress, 3d Session Committee Print—As Agreed to in Conference, Sec. 1000.)

The Conference Committee restored the language used in the House Bill explaining the change as follows:

"The House Bill imposed upon a domestic corporation an annual excise tax equivalent to $1 for each $1,000 of so much of the *fair average value of its capital stock* for the preceding year as is in excess of $5,000. It also provided that in estimating the value of the capital stock the surplus and undivided profits should be included. This is the basis of the tax under the present law, with the rate increased 100 per cent. *The Senate amendment changes the basis of the tax from the fair average value of the capital stock to the amount of the net assets shown on the books as of the close of the preceding income tax year; and the Senate recedes."* (Italics ours.)

(House Report No. 1037, 65th Congress, 3d Session, p. 84.)

Congress thus deliberately rejected as the measure of this tax the net assets as shown by the books and continued as the measure of the tax the fair average value of the capital stock of the corporation. If Congress had intended merely to reject "net assets shown by its books" for "actual value of net assets" it would have retained the words "net assets" and have modified the basis of valuation. By striking out the words "net assets" and inserting the words "fair average value of its capital stock", Congress plainly intended to adopt some other measure for this tax than that of "net assets" valued in any manner. The Court will note that the assessment of the Commissioner sought to be sustained in this case is upon the "net asset" basis, clearly rejected by Congress in adopting the report of the Conference Committee. As shown by the tabulation in Finding 16, the Commissioner determined the "Fair value of capital stock" by taking "Total liabilities" from "Total value of assets".

Action taken by the 65th Congress in fixing the basis for invested capital in this same statute, the Revenue Act of 1918 clearly rebuts any inference that it intended to adopt as a basis of this tax any valuation of corporate assets. The War Excess Profits Tax was by far the most important tax imposed by the Revenue Act of 1918, and absorbed 30%, 65% or even 80% of the net income of corporations in excess of certain credits (Sec.

301). Invested capital was a highly important factor in determining the amount of these credits (Sec. 311-312) and in determining at what rate the income should be taxed (Sec. 301). The 65th Congress was strongly urged to adopt a valuation of assets as the basis for invested capital so that all corporations would be placed upon an equal basis regardless of the time their assets were acquired. Congress refused to do so because of the insurmountable difficulty of making and checking such a valuation. The Senate Finance Committee in reporting the Revenue Bill of 1918 to the Senate said:

> "Speaking generally, assets are valued, for the purpose of determining invested capital, at the price paid in acquiring them without recognition of subsequent appreciation. Weighty arguments have been presented in favor of abandoning this rule and valuing property acquired before March 1, 1913, as of that date. But the Committee believes that such a method would be impracticable; that it would impose upon the Treasury Department the impossible task of valuing nearly all of the durable property of the country as of a date nearly six years in the past."
>
> (Senate Report No. 617, 65th Congress, 3d Session, p. 11.)

When the Revenue Act of 1918 was adopted, Congress was fully aware of the tremendous ad-

ministrative difficulties which had arisen in connection with federal taxes. It was seeking to relieve, not to increase the administrative burden. No one at that time suggested that the relatively unimportant capital stock tax involved an annual estimation of the corporate net worth of every domestic corporation including good will, unrealized appreciation, going value, or other "potentialities". No such idea is suggested by the Statute. The legislative history conclusively shows that no such meaning should be inferred.

C. The statute should not be construed in such a way as to impose upon taxpayers and the Government the burden of frequent revaluations of all corporate property and business in the United States, including the value of intangible assets.

The Court below refused to take difficulties of administration into account as an aid in construing the statute. In construing the 1917 Excess Profits Tax Act (*LaBelle Iron Works* v. *U. S., supra*), as in other instances, this Court relied upon administrative considerations in resolving the meaning of statuatory language.

Adoption of a valuation of the corporate property and business as an entirety as the basis of the capital stock tax would make necessary the determination at least once in each year of the fair value of all the corporate assets in the United

States, including unrealized appreciation, good will, going value and other intangible assets exceedingly difficult to value and in many cases not appearing on the books. To determine the "fair *average* value" of these assets "for the preceding year", as commanded by the statute would require a series of such valuations during the year. Appraisals would have to be made by taxpayers and checked by the Treasury annually or at shorter intervals of all factories, all real estate, all timber reserves and mineral deposits, all railroads and public utilities, and all equipment owned by domestic corporations. The more elusive and fluctuating intangible values would have to be appraised.

The fact that for another purpose many mining companies have had a determination of the value of their mining properties as of March 1, 1913, would not justify the general use of these valuations for later years. *The depletion values as of March 1, 1913, established by the Income Tax Unit, are not satisfactory evidence of asset values in 1919 and later years because conditions may change radically.* Yet the Treasury customarily uses the valuations as of March 1, 1913, less an allowance for depletion sustained, as the value of the mining property in later years (*Instructions, Form 707*—1925, Return). The general use by the Treasury of such valuations, though necessarily inaccurate as applied to

periods from six to ten years later than the valuation date emphasizes the impossibility of making an annual revaluation of assets.

The Senate Finance Committee well said that valuations of all corporate property could not be made (*supra,* p. 49). The Interstate Commerce Commission, over a long period and with a large staff of engineers and at great expense to the Government and to the railroads, has found it most difficult to make a single valuation of the railroads of the country for rate purposes (*Delaware & Hudson R. R. Co.* v. *I. C. C.*, pending, U. S. Sup. Ct.). Valuation annually, or at shorter intervals, of all corporate assets, including railroad assets, would be very much more difficult. All the familiar but difficult problems of public utility valuation would be present, for public utility corporations are subject to the tax. The Treasury has had great difficulty in fixing mineral, oil, gas and timber values as of March 1, 1913, for determining depletion deductions for income tax purposes. The Tax Simplification Board states, "In view of the time that has been consumed in the valuation of the railroads, and in further view of the much greater difficulty encountered in valuation of natural resources, it is apparent that in the time at its command the Bureau of Internal Revenue can not do better than make a very rough approximation of the value of natural resources." (See 1st Report Tax Simpli-

fication Board, Appendix, p. 90.) Yet the Court is asked to hold that this tremendous annual valuation burden was imposed by Congress on the Treasury and the corporations of the country to determine a relatively minor tax.

In holding that Congress adopted cost rather than later values of corporate assets as the measure of invested capital for the purposes of the excess profits tax, this Court supported its construction of the statute by the following reference to the practical difficulty of making valuations:

> "It is clear enough that Congress adopted the basis of 'invested capital' measured according to actual contributions made for stock or shares and actual accessions in the way of surplus, valuing them according to actual and *bona fide* transactions and by valuations obtaining at the time of acquisition, not only in order to confine the capital, the income from which was to be in part exempted from the burden of this special tax, to something approximately representative of the risks accepted by the investors in embarking their means in the enterprise, *but also in order to adopt tests that would enable returns to be more easily checked by examination of records, and make them less liable to inflation than if a more liberal meaning of 'capital and surplus' had been adopted; thus avoiding the necessity of employing a special corps of valuation experts to grapple*

with the many difficult problems that would have ensued had general market values been adopted as the criteria." (Italics ours.)

La Belle Iron Works v. *U. S.*, 256 U. S. 377, 389 (1921).

Adoption of the share basis, prescribed by the statute, in contrast makes it comparatively easy in the case of most important corporations to determine the amount of their capital stock tax. The stock of corporations is sold with much more frequency than the assets. The stock of a great many corporations is regularly dealt in from day to day on organized exchanges or markets, and the market price is permanently recorded in available form. The capital stock tax of the corporations representing a very large proportion of the corporate wealth of this country can, therefore, be determined on the basis of actual sales of the shares of stock. The value of the stock of close corporations can be determined in the light of ascertained values of comparable active stocks. Many such stocks are valued from time to time by Federal or State authorities for inheritance tax or other purposes. Shares certainly are more often sold or appraised and are far more easily valued in all cases, than assets. Adoption of the share basis will keep the law administrable and make possible its uniform application to all taxpayers.

The apparent willingness of the Treasury to use the impossible test of valuing assets and its

final action in this specific case in stating an asset value for December 31, 1919, does not make that course any more defensible or practicable. Nor does it render any more defensible an interpretation of the law which would impose this stupendous and contentious task. These administrative considerations help to show the probable intent of Congress. They support and fortify appellant's position.

D. The fact that this statute is a federal excise tax on corporations does not indicate that the measure of the tax is the value of the corporate net assets or that a broad, flexible and indefinite measure must be adopted. The use of the fair average value of the shares as the measure of the tax is consonant with the general purpose and nature of the statute.

The capital stock tax is a special excise tax with respect to carrying on or doing business imposed on corporations. The nature and characteristics of such a tax are fully discussed by this Court in *Flint* v. *Stone Tracy Co.,* 220 U. S. 107 (1911). That decision emphasized the broad power of Congress to adopt any measure which it chose for such a tax and sustained a corporation excise tax measured by net income. That Congress has the power to measure the capital stock tax by the fair average value of the shares of capital stock cannot be doubted.

Hamilton Co. v. *Massachusetts,* 6 Wall. 632 (1867).

The Delaware Railroad Tax, 18 Wall. 206 (1873).

The Court below seemed to think that because this is an excise tax on corporations on the privilege of doing business as such, it must be measured by the value of the privilege

> "ascertainable from the net value of its holdings, its possessions, the things tangible and intangible which concentrated into a single unit are fundamentally its capital stock, from which earnings and dividends are expected to flow"

and that since this is a tax upon the corporation, it must be measured by its resources and not by property emanating from the corporation but belonging to the individual stockholders, *i. e.,* the shares of stock.

It is by no means true, however, that the tax on a privilege must be measured by the value of the privilege. Such a tax may be measured by any relevant standard selected by Congress. In fact, such taxes have not usually been measured by the value of the privilege.

United States v. *Singer,* 15 Wall. 111 (1872), Capacity and production.

Patton v. *Brady,* 184 U. S. 608 (1902), Pounds tobacco manufactured.

Cornell v. *Coyne,* 192 U. S. 418 (1904), Production filled cheese.

McCray v. *United States,* 195 U. S. 27 (1904), Production colored oleomargarine.

Spreckels Sugar Refining Co. v. *McClain*, 192 U. S. 397 (1904), Gross receipts.

Flint v. *Stone Tracy Co.,* 220 U. S. 107 (1911), Net income from all sources.

Furthermore, the idea that the value of the privilege of doing business as a corporation is the net value of the corporate resources is clearly wrong. The property and business may be just as valuable if used or carried on as a partnership, trust or individual. The loss of the corporate charter would not destroy the value of the property. The value of the privilege of doing business as a corporation is by no means the net value of the corporate assets and business.

The reasoning of the Court below based on the nature of the tax wholly disregards the marked difference between a tax on corporate *property* and an *excise* tax. A state corporation tax on property, even though stated to be a tax on "capital stock", is necessarily a tax measured by the value of the property of the corporate taxpayer. In such cases the courts hold that the nature of the tax shows that the term "capital stock" means the property of the corporation, although recognizing that this gives to that term a non-technical and unusual meaning.

I Cook on Corporations, 8th Ed., p. 47, and cases cited note 2.

People, ex rel. Union Trust Co. v. *Coleman,* 126 N. Y. 433 (1891).

The New York Court of Appeals recently characterized "capital stock" so interpreted as "an unfortunate expression interpreted to mean property rather than shares of capital stock".

People v. *Cantor,* 236 N. Y. 417, 424 (1923).

An excise tax on corporations, however, may as readily be measured by the value of the shares —property emanating from the corporation and owned by the stockholders—as by the corporate property. An excise tax on corporations measured in this way is and has been in force in Massachusetts for many years.

Commonwealth v. *Hamilton Mfg. Co.,* 12 Allen 298 (1866).

Since Congress cannot tax corporate property directly without apportionment, the presumption arising from the nature of this Federal excise tax is rather that some measure other than the value of the property of the corporation was adopted by Congress.

The nature of this tax also furnishes no support for the adoption of the broad, flexible construction of the statute advocated by the Government under which the Commissioner of Internal Revenue is to value "the entire potentiality of the corporation to profit by the exercise of its corporate franchise." The nature of a tax

statute is such as to require a measure of tax which is both definite and uniform for all taxpayers. The chief characteristic of the broad, flexible interpretation of the statute is its indefiniteness and the possibility which it affords of the actual use of different measures of tax for different corporations (see *infra,* p. 75). The fact that the tax must be imposed on many corporations and be applied to an infinite variety of situations furnishes no basis for an indefinite and vague construction of the statute. No matter how many corporations are subject to the tax, the measure must be both ascertainable and uniform. The evidence which the Commissioner may consider in valuing this definite and uniform measure may, however, assume any form.

This broad flexible construction of the statute was apparently adopted by the Court in *Central Union Trust Co.* v. *Edwards,* 287 Fed. 324 (certiorari denied 262 U. S. 744), *a case in which the distinction here made between assets and shares was not presented to the Court,* both parties agreeing that the tax should be measured by asset values.

In that case the stock of the Trust Company had a book value of over $400 per share and had sold during the preceding year at an average market price of $788.75 per share. No good will was carried on the books. Dividends for five years past had been over 50% per annum. In

assessing the capital stock tax the Commissioner used as the basis of the assessment "fair value of the total capital stock, *i. e.*, 50,000 shares at $575.97 per share."

The taxpayer claimed that the capital stock tax should be based upon the capital, surplus and undivided profits as shown by its books (the accuracy of which was not challenged), *i. e.*, the tangible corporate assets. The Commissioner of Internal Revenue asserted the right to base the tax on a larger amount arrived at by taking the outstanding shares of stock at $575.97 per share, this figure apparently being an estimate of the fair average value of each share based upon a consideration of the past earnings of the corporation, its record of dividends, and the sales of stock, which were private sales and few in number.

In supporting this assessment before the Court, the Collector contended that the aggregate value determined by the Commissioner on a share basis fairly measured the value of the corporate assets tangible and intangible. Although the Commissioner of Internal Revenue made the assessment on a share basis, both the Collector and the taxpayer contended that the tax should be measured by the value of corporate assets. The taxpayer contended that only tangible assets shown by its books should be included. The Collector

contended that intangible assets at a valuation should also be included.

The Circuit Court of Appeals stated the issue as follows:

> "This reduces the present inquiry to the question whether Congress meant that, in measuring this excise tax, regard should be had only to what the corporation owned in its corporate capacity, and capable of admeasurement permitting entry on its book of account, *i. e.,* its tangible assets, or whether there should be taken into consideration the public opinion, reflected by the open market, of what it was worth to share in the handling of those tangible assets, *i. e.,* its good will, good management, and established capacity for earning profit" (p. 326).

That Court concluded that the Commissioner of Internal Revenue is permitted *and required* to consider not only paid in capital, surplus and undivided profits but earnings and market values of shares, thereby valuing the intangible as well as the tangible assets.

Both parties in that case proceeded under the assumption, and, therefore, the Court itself proceeded upon the assumption, that corporate *assets of some kind* were to be valued, so that the contention of claimant in this case that the capital stock tax is to be measured by valuation of shares of stock was not considered by the Court.

The use of share values as the measure of this Federal corporate excise tax is entirely consistent with the nature of the tax. Such stock represents the entire beneficial interest in the corporation. The value of such stock is the public estimation of the worth of the right to participate in the results of the corporate enterprise under all the existing circumstances. This value furnishes a measure having a natural and reasonable relation to the corporate enterprise and a measure which Congress might well deem it wise to adopt for a tax of this kind.

Corporate excise taxes imposed by State Legislatures have been measured by the market value of the shares of capital stock. Such a tax has been in force in Massachusetts since 1864, with the sanction of the Massachusetts Courts, approved by this Court.

Commonwealth v. *Hamilton Mfg. Co.*, 12 Allen 298 (1866).

Hamilton Co. v. *Massachusetts*, 6 Wall. 632 (1867).

National Bank of Commerce v. *New Bedford*, 175 Mass. 257 (1900).

The Delaware Railroad Tax, 18 Wall. 206 (1873).

The Treasury in administering the 1916 capital stock tax law initially adopted the position that the measure of the tax was the fair

average value of the shares of stock and adhered to this position for some two years (*Art. 6, Reg. 38*). The Treasury thus recognized clearly that the use of such a measure for a Federal corporate excise tax was natural, reasonable and proper.

The construction of the statute which appellant urges is thus entirely in accord with the general nature and purpose of the statute.

E. Measured by the value of shares of stock, the capital stock tax is constitutional; measured by the value of assets it is in substance an unapportioned direct tax and of doubtful constitutionality.

Where the meaning of a statute is doubtful, the Court will not adopt a construction which raises grave constitutional doubts when another construction avoids them.

United States v. *Delaware & Hudson Co.*, 213 U. S. 366 (1909).

The contention that the measure of the tax is a valuation of corporate assets raises a constitutional question. A corporate excise tax based on a valuation of shares is of undoubted constitutionality.

Congress has, of course, no power to levy a direct tax without apportioning the tax among the several states according to their respective numbers (*Article I, Section 2, Paragraph 3* of

Constitution). A tax on property is a direct tax, invalid unless apportioned.

Pollock v. *Farmers Loan & Trust Co.*, 157 U. S. 429 (1895).

It may be argued that the capital stock tax, even though construed to be a tax measured by the value of the corporation's assets, business and property, is valid as an excise tax imposed only upon corporations carrying on or doing business, and not a burden on property merely because of its ownership.

Flint v. *Stone Tracy Co.*, 220 U. S. 107 (1911).

It would seem, however, that the Court must look at the substance of the matter as it did in the *Child Labor Tax* case (*Bailey* v. *Drexel Furniture Company*), 259 U. S. 20 (1922), and recognize that the tax so administered would be in effect a direct tax on corporate assets, and that though called an excise tax by Congress it would not differ essentially from a direct tax. The sole object and purpose of most corporations is to carry on or do business, and there is no other reason or justification for their existence or for their ownership of property. In most cases the tax on their property would thus be a burden on property merely by reason of its ownership.

A tax on farm lands would be a direct tax and would be void unless apportioned. Would such

a tax be saved if it were described as a tax on "doing business as a farmer" measured by the value of the farm lands, these being valuable only for farming purposes? Paraphrasing the language in *Child Labor Tax* case (*supra*), the Court might well say:

> Grant the validity of this law and all that Congress would need to do hereafter in seeking to impose direct taxes without apportionment among the states, as required by the Constitution, would be to enact a law levying a tax measured by asset values but not due where the property owners do not carry on the business in which such property is ordinarily employed. To give such magic to the exemption of those not engaged in business would be to break down the constitutional requirement that direct taxes be apportioned among the several states according to their respective numbers.

The decision in *Flint* vs. *Stone Tracy Co.* (*supra*) sustaining a corporation excise tax, measured by income, although an income tax would have been invalid under *Pollock case* (*supra*) as an unapportioned direct tax, should not be extended to validate an unapportioned tax measured directly by asset values. That would make almost wholly ineffective the Constitutional requirement that direct taxes be apportioned.

It is common knowledge that three of the largest American mining corporations (Chile Exploration Company, Braden Copper Company, and Cerro de Pasco Copper Corporation) operate solely in South America and that practically their entire physical assets and mining property are located outside of the United States; and the valuable natural resources of other domestic corporations are scattered over other continents, beyond the Federal taxing power. Direct taxes could not be imposed on such assets outside the United States.

Congress cannot levy unapportioned direct taxes on property, and cannot tax property located without the United States, and cannot accomplish these results under the guise of an excise tax on the privilege of doing business in the corporate capacity, differing in no substantial respect from a direct tax. The contention that the capital stock tax is measured by a valuation of assets thus raises a grave constitutional question.

The capital stock tax measured by share values is not a tax on the owners of the shares, hence in no sense is it an unapportioned direct tax. It is a tax on the corporation for the privilege of doing business measured by the actual value of its shares, a measure bearing a close and reasonable relation to the corporate business done and constituting the public estimation of the value of the right to participate in it. A corporation ex-

cise tax based upon the value of the shares of stock of the corporation is clearly constitutional, as is shown by *Hamilton Company* v. *Massachusetts,* 6 Wall. 632 (1867). That decision sustained a Massachusetts statute imposing an excise tax on corporations based on the market value of the shares of capital stock.

See also

> *The Delaware Railroad Tax,* 18 Wall. 206 (1873).

These constitutional considerations furnish an additional ground for holding that the statutory measure of the capital tax is a valuation of the shares of stock rather than a valuation of the assets, property or business of the corporation.

II.

The fair average value of the shares of stock is primarily determined from market transactions when available in sufficient volume.

Under appellant's construction of the statute, the ultimate fact to be established in every case is the fair average value of the shares of stock. This value is to be established in the ordinary way just as it would be established for any other purpose. The most direct and persuasive evidence of such fair average value is afforded by the record of sales of such shares. In this case such sales in large volume on almost every business day of the critical year establish the fair average value of the shares of stock for that period as $34,803,608.99, the amount reported by appellant (Findings 5 to 8). The assessment by the Commissioner based upon a valuation of corporate assets amounting to $55,833,541.66 is thus excessive and invalid.

It will scarcely be controverted that "value" when applied without qualification to property, means market value, that market value is fair and that an average of market values gives the fair average value of the property.

Fox v. *Phelps,* 17 Wend. N. Y. 393, 407 (1837).

Hetland v. *Bilstad,* 140 Ia. 411 (1908).

Palmer v. *Penobscot Lumbering Association,* 90 Me. 193 (1897).

Schley v. *Montgomery County,* 106 Md. 407 (1907).

Duncan v. *Landis,* 106 Fed. 839, 862 (1901).

Advisory Tax Board Recommendation 57, Internal Revenue Bulletin, Cumulative Bulletin 1919, p. 40.

The best evidence of the fair market value of shares of stock is the record of sales of such stock and where a satisfactory record of sales exists, that record is controlling evidence of the fair market value of the stock.

People ex rel. Knickerbocker Fire Insurance Co. v. *Coleman,* 107 N. Y. 541 (1887).

Treasury Regulations 63, Revised 1922, Articles 13 and 14, dealing with valuation of stock for Federal estate tax purposes.

Advisory Tax Board Memorandum 73, Internal Revenue Bulletin, Cumulative Bulletin 1919, p. 71.

Committee on Appeals and Review Recommendation 33, Internal Revenue Bulletin, Cum. Bul. June, 1920, p. 30.

Where the shares are to be valued, the Courts and the Treasury Department alike adopt the es-

tablished market price as the fair market value rather than the book value or the value of the stock based upon corporate asset values.

National Bank of Commerce v. *New Bedford,* 175 Mass. 257 (1900).

Commonwealth v. *Cary Improvement Co.,* 98 Mass. 19 (1867).

National Bank of Commerce v. *New Bedford,* 155 Mass. 313 (1892).

Schley v. *Montgomery County,* 106 Md. 407 (1907).

Newark v. *Tunis,* 82 N. J. Law, 461 (1911).

Committee on Appeals and Review Recommendation 4837, Internal Revenue Bulletin, Cum. Bul. III-1, p. 39.

Committee on Appeals and Review Recommendation 2771, Internal Revenue Bulletin, Cum. Bul. II-2, p. 18.

In *National Bank of Commerce* v. *New Bedford,* 175 Mass. 257 (1900), the respondent had objected to the exclusion of evidence showing the intrinsic value of the assets as tending to establish the fair cash value of the shares of stock. Holmes, *J.,* for the Court, said:

> "There was an ascertainable sum for which these shares could have been sold on May 1, and that being so, it was useless to prove that the public ought to have been willing to give more. * * *

"But, generally speaking, when a statute requires the 'fair cash value' of property on a certain day to be ascertained, Pub. Sts. c. 13, Sec. 8, it refers to the actual judgment of the public as expressed in the price which some one will pay, not to what the court at a later time may think would have been a wiser opinion. It means the highest price that a normal purchaser, not under peculiar compulsion, will pay at that time to get that thing. * * * But it appears to us that the excess of assets over liabilities is of no importance for that purpose, as it throws no light whatever upon the selling prices of the stock. There was sufficient evidence upon which to form an opinion of the selling price, defined as we have defined it, without the need of resorting to such indirect methods of getting at it, and therefore the attempt to divert the inquiry into a wrong channel was met properly enough by a rejection of the evidence."

A satisfactory record of sales, if available, therefore, directly establishes the fair average value of the shares of stock. This is the ordinary method of valuing shares used by the Courts generally and used by the Treasury in other connections. Congress intended that this method of determining the "fair average value" of the capital stock "for the preceding year" under this statute, should be employed, as is made clear by the House debate quoted at page 42 of this brief.

In cases where there are no sales of stock or where the sales are for any reason unsatisfactory evidence of the fair average value of the stock, the Commissioner of Internal Revenue must of necessity resort to indirect and secondary evidence of such value. In such cases, he may doubtless take into account the fair value of the corporate assets during the year, the earnings of the corporation, its record of dividend payments, the nature of its business, its future prospects, its management, valuations of the stock for inheritance tax purposes and any other evidence tending to show the fair average value of the stock for the preceding year. In such cases, the value of the corporate assets will undoubtedly be one factor, but in every case it will be the fair average value of the shares which is determined. The Commissioner may well require full information as to property and earnings from corporations the fair average value of whose stock is readily determined from market transactions, so as to be assisted in estimating the proper value in cases in which no such transactions are available. This again was the intention of Congress. Quoting from the debate set forth more fully on page 42 of this brief.

> "Mr. Kitchin: * * * We have put a tax of 50 cents a thousand upon the fair average value of the capital stock.
>
> Mr. Denison: That means the market value?

Mr. Kitchin: When it has a market value, it would be the market value; but some stocks have no market value, and they would have to ascertain what the fair actual value is."

The value of the corporate assets may also be useful to the Commissioner in determining whether or not the record of sales of shares should be accepted as satisfactory evidence of the fair average value of the total stock.

In making such use of asset values, however, it must be recognized that corporate asset values are secondary and unsatisfactory evidence of share values. Assets and shares are not legal equivalents, do not have the same value and cannot be treated as if interchangeable. The value of the shares is affected by many influences which do not affect the value of the assets. It is everyday experience that the two things differ greatly in value.

In this case, resort to secondary evidence is unnecessary. There was a satisfactory record of *bona fide* sales in large volume upon a free and open market. These sales satisfactorily establish the fair average value of the shares of stock. The Government has not disputed this.

It might be assumed from statements of the Court below that appellant contends that the measure of the tax was the fair average value of the shares where there were sales of stock and

that where there were no sales of stock the measure of the tax was the fair value of the corporate assets. Appellant, of course, takes no such position. It contends that in every case the measure of the tax is the fair average value of the shares of stock and that this is to be established in each case in the ordinary manner upon the basis of all the available evidence just as such value would be ascertained for any other purpose.

III.

The Treasury has in practice construed the law as if it measured the tax by (1) assets, (2) shares or (3) capitalized earnings, whichever is higher. This construction of the statute is erroneous, even if presented under the guise of a broad meaning for the term "capital stock".

The issue presented to this point is primarily that between the use of shares and the use of assets as the measure of the tax. There has been no issue between the Government and the appellant as to the method of valuing shares. Appellant takes the position that the statutory measure of the tax is the fair average value of the shares. The court below took the position that the measure of the tax is the fair value of the corporate assets and resources and approved the assessment made solely on that basis.

The Treasury originally adopted appellant's construction of the statute (*Article 6, Regulations 38* set forth in appendix to this brief). Its present interpretation of Section 700 of the Revenue Act of 1924 (identical with Section 1000 of the Revenue Act of 1918, except as to insurance companies), while emphasizing asset values, does not proceed on the basis that "capital stock" means net assets (*Article 15, Regulations 64, 1924 Edition,* set forth in appendix). The Treasury, except in its first regulations, has

carefully refrained from stating what "capital stock" does mean in this statute. It requires a statement of assets at "fair value" showing the net value of the corporate assets at the date of the last balance sheet (Exhibit A, form 707), a statement of sales of shares showing the total value of the shares at the average selling price during the year (Exhibit B, form 707), and a statement of the preceding five years' earnings and dividends showing a total value determined by capitalization of earnings (Exhibit C, form 707).

Form 707, 1925 return, continues an instruction which has appeared on several forms reading:

> "If the reconstructed book value shown by Exhibit A, the market value shown by Exhibit B, or the valuation reflected by Exhibit C is greater than the valuation returned by the taxpayer, a comprehensive statement showing any extraordinary conditions which are relied on in support of the valuation claimed must be submitted."

In practice therefore the Treasury requires the statement of three different amounts arrived at in different ways and representing different things and, except under extraordinary and unspecified conditions, measures the tax by the highest of these amounts. It thus construes this statute in such a way as to permit it to tax ap-

pellant on the basis of corporate assets, some other corporation on the basis of share values and a third corporation on the basis of a capitalization of earnings.

Presumably the Government will not take the position in this case that the Commissioner of Internal Revenue has discretion under the statute to tax a corporation either on the fair value of its net assets, the average value of its shares of stock as shown by sales thereof, or an amount determined by capitalizing past earnings, although this is the practice of the Treasury. Such an argument would too plainly set up an alternative measure clearly not contemplated by the statute. The statute establishes a single standard —a single thing to be valued—which must be the same for all taxpayers.

The Government defends the results of this alternative practice, however, by contending that the one of the three amounts selected by the Commissioner in a particular case must be accepted by the taxpayer as a proper determination of the "fair value". In order to reach this result, the Government attributes to the term "capital stock" a vague, elastic or flexible meaning so broad as to leave taxpayers no basis for objecting to anything which the Commissioner may do within very wide limits. This enlarged concept, well characterized as "cynical" by the Court in *Cen-*

tral Union Trust Company case (*supra*), is called there and in the decision below "the entire potentiality of the corporation to profit by the exercise of its corporate franchise". This generality seems to be as definite a statement of its concept of what is to be valued, as the Government has formulated after eight years of administration of the law.

The Government defended the capital stock tax assessment made in *Central Union Trust Company* v. *Edwards, supra,* on the basis of a capitalization of earnings as a proper determination of the "fair value" under its broad, flexible theory. The Circuit Court of Appeals said:

> "The remarks made by the 'committee chairman in charge of the bill' * * * are available in Cong. Rec. 64th Cong. 1st Sess. September 7, 1916, and they satisfy us that the act was passed with the intent of permitting, and indeed *compelling,* the assessor to consider, not only paid-in capital, surplus and undivided profits, *but earnings and market value of shares.*" (Italics ours.)

It is by no means clear that this decision meant to approve the alternative practice of the Commissioner. The assessment was originally based on share values which gave the highest tax, but a refund was made and the assessment before the Court was based on a capitalization of earnings, and was in fact about midway between share value and asset value.

In the present case the Government defends an assessment based on asset values as a proper determination of the "fair value" under the same broad, flexible theory. The Court below, in sustaining this assessment, says:

> "Obviously, when given effect it precludes the idea of earnings of the corporations as furnishing the basis of computation for the tax. It precludes a consideration of profits and discloses an intended purpose to use assets—at least assets represented by surplus and undivided profits—as one factor in arriving at the value of capital stock. * * * When Congress expressly included surplus and undivided profits in the estimation of the capital stock of a corporation, it necessarily excluded resort to the market value of the shares of stock of the corporation, even when available, as the one and only basis of assessing an excise tax against the same, and intentionally predicated the assessment of the tax upon an asset basis."

Thus, one Court says resort to earnings and market value of shares as well as capital, surplus and undivided profits is compelled by the statute; the other says resort to earnings is forbidden by the statute, that the tax is predicated on an asset basis and that an assessment wholly disregarding the market value of the shares is proper. The two decisions are thus inconsistent in their reasoning. This is natural in view of the fact that an assessment made on one basis was sustained in the

Central Union Trust Company case, and an assessment made on a different basis was sustained below.

Appellant's position is that the statute prescribes a single measure of tax, inflexible in the sense that it is the same for all taxpayers. Furthermore, this measure must be capable of definition and the thing to be valued must be identifiable as an ordinary business concept, a "business and financial reality", susceptible of valuation by ordinary methods. Once the thing to be valued is established and defined, there is ample room for flexibility and for the exercise of judgment by the Commissioner in determining the weight, relevancy and admissibility of the evidence of value which may be of infinite variety. The Commissioner's interpretation of the statute as imposing an alternative basis is wholly inadmissible and cannot be supported by adoption of such a broad meaning for "capital stock" as to permit the actual use of alternative and distinct meanings. With reference to a somewhat similar construction of a New York property tax law, the New York Court of Appeals said:

> "The right asserted is a discretion in the assessors at their free will to assess corporations upon and at the value of their capital and surplus, or upon and at the value of the share stock independently of established facts and whenever they please. The law gives them no such discretion. How it has been

exercised and how destructively to the rights of taxpayers may be seen by comparing the action in this case with that in one of the cases which we have reviewed. Where the share stock was selling at ninety, and so below par, the assessors refused to take that value and went to the company's books in search of a larger one, which they found and adopted. Here, where the actual value of capital and surplus is established so that they frankly admit the fact, they calmly disregard it and fly to the larger value of the share stock. The statute has given them no such right. *They are not lawless rovers, wandering among corporations at will, but regular officers bound by discipline and controlled by the law, and whose discretion exists within fixed and definite limits.*"

People ex rel. Union Trust Company v. *Coleman,* 126 N. Y. 433, 449 (1891).

If the test laid down by the court in *Central Union Trust Company* v. *Edwards* is applied here, it clearly shows that the assessment based solely on net assets and without reference to the market value of the shares or other evidence is excessive. There the Court held that the Commissioner was compelled to *consider* not only paid-in capital, surplus and undivided profits, but also earnings and market value of shares. "Consider" must mean to give some weight to such evidence in the final result. The assessment there approved approxi-

mated an average of the value of the assets the market value of the shares and the capitalized earnings value. Here the Commissioner of Internal Revenue gave no weight whatsoever to the market value of the shares or to the secondary evidence of value shown in the exhibits attached to the stipulation of facts below which showed that the record of earnings, the record of dividends and the asset values at cost all substantially supported the amount directly determined from the selling value of the shares of stock. Such an assessment is clearly excessive and erroneous under the reasoning of *Central Union Trust Company* v. *Edwards* (*supra*).

The decision of the Court below was that "capital stock" meant corporate assets or resources, and is clearly wrong. It is not the interpretation of the statute adopted by the Commissioner of Internal Revenue. It is not the interpretation of the statute made in *Central Union Trust Company* v. *Edwards* (*supra*). It gives no significance to the phrase "fair average value * * * for the preceding year". It wholly disregards the contrast between "capital stock", the measure for domestic corporations and "capital employed", the measure for foreign corporations. It ignores the significant change from "capital" in the bankers tax to "capital stock" in the capital stock tax. It makes the special provisions as to mutual insurance companies surplusage. It ignores the

congressional debate in connection with the 1916 Act clearly showing that resort to the market value of the shares was the primary intent of Congress. It ignores the refusal of the 65th Congress to change the measure from "capital stock" to "net assets shown by its books". It attributes to Congress an intention to burden the Treasury and the taxpayers with the impracticable task of valuing all corporate assets in the country annually or at shorter intervals. It raises constitutional questions. This interpretation of the statute cannot be sustained.

It is equally clear that the broad, flexible interpretation advanced to justify the practice of the Commissioner in using assets, shares or capitalized earnings as alternative bases is incorrect. The statute clearly requires the same thing to be valued for all corporations, and the effort to attribute to the words "capital stock" a meaning flexible enough to permit the use of alternative bases merely results in vagueness, uncertainty and the unsuccessful attempt to reach some elusive thing hitherto unrecognized as a business and financial reality.

An interpretation of the statute to the effect that "capital stock" means shares of stock to be valued in the ordinary way gives ordinary significance to the phrase "fair average value for the preceding year", gives full effect to the contrast between "capital stock" and "capital",

gives a meaning to the special provision as to mutual insurance companies, conforms precisely to the 1916 congressional debate and the 1918 legislative history, gives proper weight and significance to the reference to surplus and undivided profits, greatly simplifies a difficult administrative problem, avoids constitutional difficulties and results in an understandable and definable measure of tax consonant with the general nature and purpose of the statute, and applicable with uniformity and certainty to all domestic corporations.

The decision should be reversed with directions to enter judgment for the appellant for the full amount sued for.

Respectfully submitted,

Arthur A. Ballantine,
Carroll A. Wilson,
George E. Cleary,
Attorneys for Appellant.

Appendix.

1. Article 6, Treasury Regulations No. 38, issued October 9, 1916, under Sec. 407, Revenue Act of 1916:

"United States corporations.

Art. 6. Sec. 1. *Companies or associations organized in the United States for profit.*—The tax on companies or associations having *a capital stock represented by shares* is imposed on the fair average value for the preceding year and *not the face or par value* of the capital stock. The fair value of the capital stock shall be ascertained as follows:

"*Stock* listed on exchange.

"(*a*) *Case I.*—If the *stock is listed on any exchange* its fair value will be determined by adding the *quoted highest bid price* for the stock on the last business day of each month during the preceding fiscal year (or if no bid price was quoted on the last day then the latest day in the month on which a bid was quoted), and dividing by 12, *the result being the average bid price per share for that year.*

"*Stock* not listed, but of which sales have been made.

"(*b*) *Case II.*—If the *stock* is *not listed* on any exchange, but *sales thereof* have been actually made, and the *price paid for the stock* is known to the officer making the return, or

can be discovered by him, ***the average price at which sales were made*** during the preceding fiscal year shall be the determining factor in ascertaining the fair value per share.

(*In the foregoing two cases the actual fair value of the stock is ascertainable from the facts without the necessity of making an estimate.*)

"Cases in which fair average value of stock shall be estimated.

"(*c*) *Case III.—If Case I and Case II can not be applied, viz.,* the stock is not listed on any exchange, and no actual sales have been made during the preceding fiscal year, or if the price at which sales have been made is not known to the officer making the return, the fair average value of the capital stock shall be estimated, and the surplus and undivided profits for the preceding fiscal year will be taken into consideration as required by the statute, as well as the nature of the business, its earning capacity and average dividends paid, or profits earned during the preceding five years.

"Fair value of total *capital stock outstanding.*

"(*d*) The *fair value per share* ascertained or estimated as above multiplied by the number of shares outstanding will give the fair value of the *stock* for taxation purposes. * * *" (Italics ours.)

2. *Article 15, Treasury Regulations 64—1924 Edition.*

"Art 15. *Fair average value of capital stock.*—The fair average value of the capital stock for the purpose of determining the amount of the capital stock tax must not be confused with the market value of the shares of stock where it may be necessary to determine such value under other provisions of the revenue laws. The fair average value of the capital stock, the statutory measure of the tax, is not necessarily the book value or the value based on prices realized in current sales of shares of stock or the value determined by capitalization of earnings.

"Form 707 provides Exhibit A for the book or fair value of the assets, Exhibit B for the market value of the shares, and Exhibit C for the value of the capital stock based on the capitalized earnings. All information called for must be given in every case where it is procurable. The fair average value of the capital stock of a corporation and the tax payable thereon shall be determined from a consideration of the data contained in the return as well as all elements and factors affecting values, which should be harmonized so far as possible in the ultimate fair value found. Fair value is required irrespective of the exhibit used or the method employed in its determination.

"Exhibit A.—The character of the assets is probably the most important factor in de-

termining the reliability of the value reflected by this exhibit as being indicative of the fair value of the capital stock. *If the market value of the assets be established the fair value of the capital stock is held to be not materially less than the fair market value of the net assets. Attempts to average the assets as a means of estimating the fair average value of the capital stock are not permitted.*

"Exhibit B.—The market is regarded as a factor, but only of importance when the underlying factors upon which the market has been established are sound in all essential particulars.

"Exhibit C.—The weight attaching to this exhibit is largely dependent upon the nature of the business and character of the assets. In capitalizing the net earnings of the corporation, which should reflect the true earning capacity, the officers should use a rate fairly representing the conditions obtaining in the trade and in the locality, with due regard to other important factors, including the worth of money. But such fair value must not be greatly at variance with the reconstructed book value shown by Exhibit A, unless the corporation is materially affected by extraordinary conditions which support a lower valuation. In any such case a full explanation must accompany the return. The commissioner will estimate the fair value of the capital stock in cases regarded as involving any understatement or undervaluation.

"The fair value of the capital stock, as provided under section 700 (*a*) (1) of the Revenue Act of 1924, and invested capital are not necessarily the same.

"For the purpose of capital-stock tax the fair value of the capital stock is estimated, and is predicated on present values, including actual appreciation of property, whether realized or unrealized, and such intangible assets as good will, trade-marks, and patents to the extent reflected by the earning power, whereas invested capital is based upon the actual investment of the stockholders in the corporation, irrespective of the present value of its assets. *In the case of the capital-stock tax the fair value looks to the present net value of the assets,* irrespective of the amount of the investment of the stockholders." (Italics ours.)

Note.—Sec. 700 of Revenue Act of 1924 is identical with Section 1000 of Revenue Act of 1918, except for exemption of insurance companies.

3. *Extract from First Annual Report of the Tax Simplification Board (Sec. 1327, Rev. Act 1921) dated Dec. 2, 1922.*

"Another factor involving exceptional difficulty is found in the administration of the provisions of the revenue acts which allow a deduction for the depletion of minerals and other natural resources. This, also, has the

appearance of justice and comparative simplicity. What is actually involved, however, is the valuation as of March 1, 1913, or other basic date, of all the natural resources of the country which are under operation for profit. Most of this property is under the ground and hidden from sight. It must be brought to the surface at varying and uncertain dates in the future, at varying and uncertain costs, and sold on the basis of the market as it exists from time to time in the future. The quantity of property can in but few cases be measured. It can only be approximated, and its value, based upon these uncertain factors, must be reduced to a present sum which, in theory, will be paid by a willing purchaser to a willing seller. The valuation of the railroad properties of the country has been under way for years and that problem is easy as compared with the valuation problem incident to the calculation of the allowance for depletion. In view of the time that has been consumed in the valuation of the railroads, and in further view of the much greater difficulty encountered in valuation of natural resources, it is apparent that in the time at its command the Bureau of Internal Revenue can not do better than make a very rough approximation of the value of natural resources."